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EXPOSURE DRAFT

OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

PROPOSED INTERPRETATION UNDER RULE 102: Professional Services Involving Client Advocacy ☐ PROPOSED REVISION OF INTERPRETATION 102-2 UNDER RULE 102: Conflicts of Interest ☐ PROPOSED RULING UNDER RULE 102 AND RULE 301: Member Providing Services for Company Executives ☐ PROPOSED REVISION OF INTERPRETATION 101-10 UNDER RULE 101: The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements

MARCH 1, 1995

Prepared by the AICPA Professional Ethics Executive Committee for comments from persons interested in independence, behavioral, and technical standards matters

**Comments should be received by May 31, 1995, and addressed to
Herbert A. Finkston, Director, Professional Ethics Division,
AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.**

*This exposure draft has been sent to persons
who have requested copies.*

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Any individual or organization may obtain one copy of this document without charge until the end of the comment period by writing to the AICPA Order Department, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

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March 1, 1995

This exposure draft contains four proposals for review and comment by the Institute's membership and other interested parties regarding pronouncements to be adopted by the Professional Ethics Executive Committee. The text of and an explanatory preface to each pronouncement are included in this exposure draft.

A summary does not accompany this exposure draft because of the diversity of material included. Instead, the type of information a summary would contain is included in the "Explanation" preceding each proposal.

After the exposure period is concluded and the comments evaluated by the Professional Ethics Executive Committee, the committee may decide to publish one or more of the proposed pronouncements. Once published, the pronouncements become effective on the last day of the month in which they are published in the *Journal of Accountancy*, except as otherwise stated in the pronouncements.

Your comments are an important part of the standard-setting process. Please take this opportunity to comment. Responses should be made under the appropriate heading on the enclosed response form. They must be received at the AICPA by May 31, 1995. All written replies to this exposure draft will become part of the public record of the AICPA and will be available for inspection at the office of the AICPA after June 30, 1995, for a period of one year.

Please send comments to Herbert A. Finkston, AICPA Professional Ethics Division, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

Sincerely,



L. Glenn Perry
Chair
AICPA Professional Ethics
Executive Committee



Herbert A. Finkston
Director
AICPA Professional
Ethics Division

PROPOSED INTERPRETATION UNDER RULE 102

[Explanation]

The Professional Ethics Executive Committee has rewritten its proposed interpretation on client service and client advocacy based on the comments received from the membership to a previously exposed proposed interpretation (July 26, 1994). The following proposed pronouncement is intended to clarify the application of the Code of Professional Conduct to situations where members perform advocacy services for clients by noting that such services are appropriate only when performed in accordance with professional standards and applicable rules of conduct and by providing guidelines within which members may apply professional judgment in determining when the performance of such services is inappropriate.

[Text of Proposed Interpretation Under Rule 102]

Professional Services Involving Client Advocacy

A member or a member's firm may be requested by a client—

- a.* To perform tax or consulting services engagements that involve acting as an advocate for the client.
- b.* To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard-setters, regulators, or others.

Services provided or actions taken pursuant to such types of client requests are professional services [ET section 92.10] governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201, *General Standards*, Rule 202, *Compliance With Standards*, and Rule 203, *Accounting Principles*, and interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with rule 102, which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with rule 101 of the Code of Professional Conduct.

Moreover, there is a possibility that some requested professional services involving client advocacy may appear to stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk of impairing the reputation of the member and his or her firm with respect to independence, integrity, and objectivity. In such circumstances, the member and the member's firm should consider whether it is appropriate to perform the service.

PROPOSED REVISION OF INTERPRETATION 102-2 UNDER RULE 102

[Explanation]

To assist members in the application of Interpretation 102-2, *Conflicts of Interest*, the Professional Ethics Executive Committee, in consultation with the tax, personal financial planning, and management consulting services divisions, has developed several situations that should cause a member to consider whether or not the client, employer, or other interested parties could view a particular relationship as impairing his or her objectivity.

[Text of Proposed Interpretation 102-2]*

.03 102-2 — Conflicts of Interest. A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a ~~significant~~ relationship with another person, entity, product, or service that could, **in the member's professional judgment**, be viewed **by the client, employer, or other interested parties** as impairing the member's objectivity. If **the member believes that the professional service can be performed with objectivity, and the** ~~this significant~~ relationship is disclosed to and consent is obtained from such client, employer, or other ~~appropriate~~ **interested** parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider [R]ule 301, *Confidential Client Information* [ET section 301.01].

Certain professional engagements, **such as audits, reviews, and other attest services**, require independence. Independence impairments under rule 101 [ET section 101.01], its interpretations, **and rulings** cannot be eliminated by such disclosure and consent.

The following are examples, not all inclusive, of situations that should cause a member to consider whether or not the client, employer, or other interested parties could view the relationship as impairing the member's objectivity.

- A member has been asked to perform litigation support services for the plaintiff in connection with a lawsuit filed against a client of the member's firm.
- A member has provided tax or personal financial planning services for a married couple who is undergoing a divorce, and the member has been asked to provide the services for the couple during the divorce proceedings.
- In connection with a personal financial planning engagement, a member plans to suggest that the client invest in a business in which he or she has a financial interest.
- A member provides tax or personal financial planning services for several members of a family who may have opposing interests.
- A member has a significant financial interest, is a member of management, or is in a position of influence in a company that is a major competitor of a client for which the member performs management consulting services.
- A member serves on a city's Board of Tax Appeals, which considers matters involving several of the member's tax clients.

* Deleted language is crossed out; new language is in bold print.

- A member has been approached to provide services in connection with the purchase of real estate from a client of the member's firm.
- A member refers a personal financial planning or tax client to an insurance broker or other service provider, who refers clients to the member under an exclusive arrangement to do so.

The above examples are not intended to be all-inclusive.

PROPOSED RULING UNDER RULE 102 AND RULE 301

[*Explanation*]

In connection with the proposed revision to Interpretation 102-2, *Conflicts of Interest*, the Professional Ethics Executive Committee believes that an arrangement a member may have with a company to provide professional services to its executives requires further guidance. The proposed ruling directs the member to consider rules 102 and 301 before accepting and during the performance of such engagements.

[*Text of Proposed Ruling Under Rule 102 and Rule 301*]

Member Providing Services for Company Executives

Question — A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in the member recommending to the executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

Answer — Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102, *Integrity and Objectivity* [ET section 102.01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member should also consider informing the company and the executives of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301, *Confidential Client Information* [ET section 301.01].

PROPOSED REVISION OF INTERPRETATION 101-10 UNDER RULE 101

[Explanation]

To reflect the changes in the definition of a financial reporting entity as provided in Governmental Accounting Standards Board Statement No. 14, *The Financial Reporting Entity*, the Professional Ethics Executive Committee proposes the following complete revision of Interpretation 101-10.

The text of current Interpretation 101-10 and the proposed revision follows.

[Text of Current Interpretation 101-10 Proposed for Revision]

.12 101-10 — The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements. Under statements issued by the Governmental Accounting Standards Board, general-purpose financial statements may be issued for a governmental reporting entity, which consists of the financial statements of an oversight entity and one or more other entities (component units).

Because the oversight entity can exercise significant influence over the component units included in the reporting entity financial statements, rule 101 is applicable and requires a member issuing a report on the general-purpose financial statements to be independent of the oversight entity and of each component unit that should be included therein.

A member who is the auditor of a material component unit but is not the auditor of the oversight entity should be independent of that component unit and the oversight entity.

A member who is the auditor of only an immaterial component unit is only required to be independent of that component because it is immaterial to the reporting entity. If this same member also audited other immaterial component units that, when aggregated, are material to the reporting entity, the member should be independent of the oversight entity and of the component units that the member audits.

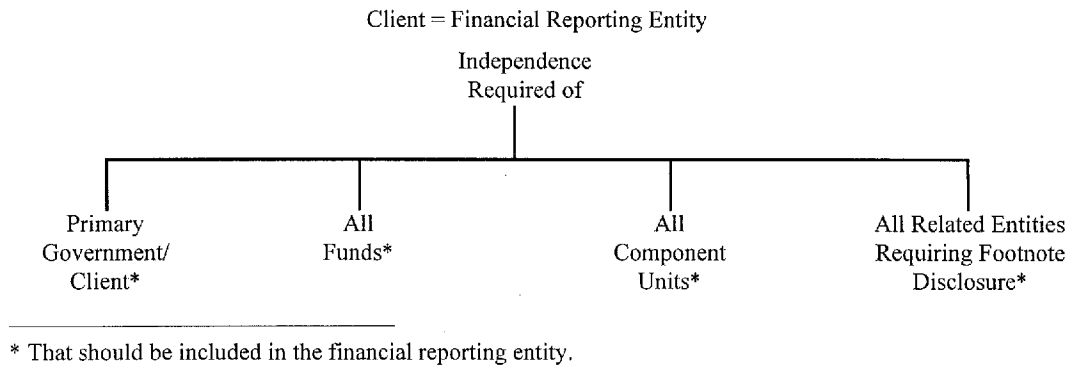
[Formerly paragraph .11, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-10, *The Effect on Independence of Relationships Proscribed by Rule 101 and its Interpretations With Nonclient Entities Included With a Member's Client in the Financial Statements of a Governmental Reporting Entity*, April 1991, effective April 30, 1991.]

[Text of Proposed Interpretation 101-10]

.12 101-10 — The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements. A financial reporting entity's general-purpose financial statements issued in accordance with Governmental Accounting Standards consist of the financial statements of the primary government (including funds and component units), financial statements of discretely presented component units and footnote disclosure of related organizations and joint ventures. For the purposes of this Interpretation, the financial reporting entity includes the primary government, including its funds and component units, related entities which should be included in the general-purpose financial statements, and related organizations and joint ventures which should be disclosed in the notes to the general-purpose financial statements.

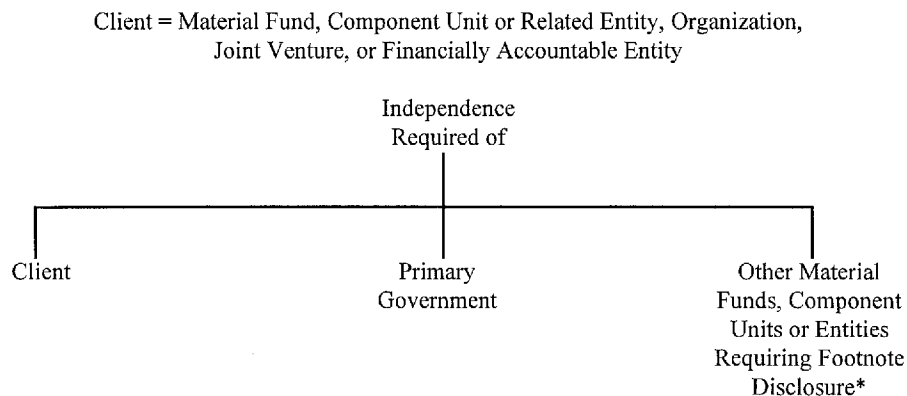
Auditor of Financial Reporting Entity

A member issuing a report on the general-purpose financial statements of the financial reporting entity should be independent of the financial reporting entity.



Auditor of Material Fund, Component Unit or Related Entity, Organization, or Joint Venture

A member who is auditing the financial statements of a material fund, component unit or related entity, organization or joint venture which should be disclosed in the general-purpose financial statements, but is not auditing the primary government, should be independent with respect to those financial statements and those of the primary government. The member is not required to be independent of other funds, component units or related entities, organizations or joint ventures of the financial reporting entity provided that they are not financially accountable for or to the organization for which the audit is being performed. Independence is considered to be impaired if the member is not independent with respect to any other fund, component unit or related entities, organizations or joint ventures which are financially accountable for or to the organization for which the audit is being performed.

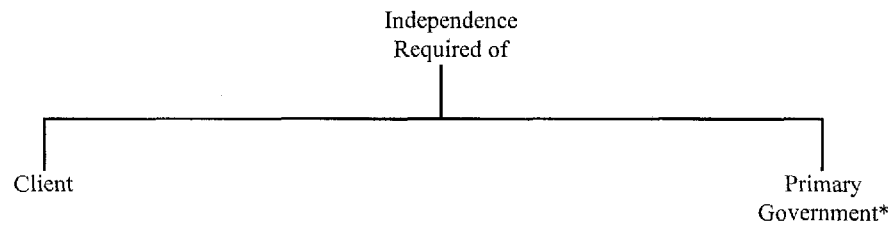


* If financially accountable for or to the client.

Auditor of Immaterial Fund, Component Unit or Related Entity, Organization, or Joint Venture

A member who is auditing the financial statements of an immaterial fund, component unit or related entity, organization or joint venture which should be disclosed in the general-purpose financial statements, but is not auditing the primary government, should be independent with respect to those financial statements and should not be associated with the primary government in any capacity described in interpretation 101-1-B. If the member is also auditing other immaterial funds, component units or related entities, organizations or joint ventures which should be disclosed in the general-purpose financial statements that, when aggregated, are material to the financial reporting entity, the member should be independent of those financial statements and the primary government.

Client = Immaterial Fund, Component Unit or Related Entity, Organization, or Joint Venture



* If member is associated with primary government in Interpretation 101-1-B capacity.

Note: If member audits several immaterial funds, component units and/or organizations requiring footnote disclosure that, when aggregated, are material to the financial reporting entity, full independence of the primary government is required.